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FISCAL IMPACT STATEMENT

LS 7454
BILL NUMBER: SB 492

NOTE PREPARED: Feb 4, 2015
BILL AMENDED: Jan 29, 2015

SUBJECT: Various Pension Matters.

FIRST AUTHOR: Sen. Boots
FIRST SPONSOR:

BILL STATUS: CR Adopted - 1st House

FUNDS AFFECTED: X GENERAL
X DEDICATED
X FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides that an individual who is a first-time full-time employee of the state after June 30, 2015, must make an election to become a member of the Public Employees' Retirement Fund (PERF). It provides that if an employee of the state does not make an election, the employee becomes a member of the Defined Contribution Plan (ASA Only Plan). (This reverses the presumption under current law.)

The bill establishes a procedure by which a political subdivision may participate in the ASA Only Plan and choose whether the political subdivision's employees participate in PERF, the ASA Only Plan, or may elect whether to participate in PERF or the ASA Only Plan. It permits a political subdivision that allows its employees to make an election to choose a default option for employees who fail to do so.

The bill permits a political subdivision to establish its employer contribution rate to the ASA Only Plan and to elect to match a percentage of its employees' additional contributions to the ASA Only Plan.

The bill also requires the board of trustees (board) of the Indiana Public Retirement System (INPRS) to assess an employer a supplemental contribution to PERF, if necessary, to fund the employer's share of the actuarial accrued liability that is unfunded because the employer's employees are members of the ASA Only Plan rather than PERF.

It requires the board to notify the Interim Study Committee for Pension Management Oversight if the board determines contributions and contribution rates for one or more employers participating in PERF or Teachers' Retirement Fund (TRF) that differ from the contributions and contribution rates recommended by the INPRS actuaries.

The bill requires the Office of Management and Budget (OMB) to report to the Interim Committee each year concerning information received from political subdivisions about the subdivisions' retirement plans other than plans administered by INPRS.

The bill establishes a procedure for a miscellaneous participating entity or political subdivision to withdraw or freeze participation in PERF. It requires a withdrawing or freezing entity or political subdivision to fully fund PERF benefits attributable to the entity's or political subdivision's employees' PERF service with the entity or political subdivision. It requires an entity or political subdivision that withdraws from or freezes participation in PERF and thereafter offers its employees a retirement benefit to participate in the ASA Only Plan.

The bill requires any other public employer that is eligible but not required to participate in PERF and that wishes to offer a retirement benefit to an employee after June 30, 2015, to participate in either PERF or the ASA Only Plan. It grandfathers participation in another defined contribution plan for entities, political subdivisions, and other public employers participating in another plan on July 1, 2015.

The bill provides that after December 31, 2015, members and beneficiaries of any public pension fund administered by INPRS may receive monthly benefits only by direct deposit or another method approved by the board.

The bill expires a section concerning other methods of paying monthly benefits to members and beneficiaries of PERF and TRF.

The bill permits a retired member of the 1977 Police Officers' and Firefighters' Pension and Disability Fund (1977 Fund) who is at least 55 years of age to: (1) be rehired by the same unit that employed the member in a position covered by the 1977 Fund for a position not covered by the 1977 fund without a minimum period of separation from employment; and (2) continue to receive the member's retirement benefit from the 1977 Fund.

Effective Date: Upon passage; July 1, 2015.

Explanation of State Expenditures: *Employer Supplemental Contributions:* The bill provides that INPRS may charge an employer a supplemental contribution, if necessary, to fund an employer's share of the actuarial unfunded liability due to the fact that all or a portion of the employer's employees are a member of the ASA Only Plan (as opposed to PERF).

This provision is not expected to have an impact on the state as an employer, as the state pays the same contribution rate (11.2% currently) for both employees in PERF as well as for employees in the ASA Only Plan. Due to this, the state pays for its share of the PERF unfunded liability through its contribution rates for all employees, making the need for this surcharge currently unnecessary.

Withdrawal/Freezing from PERF: The bill does affect the state as an employer. Currently, the state will realize an increase in its employer contribution rate over time due to the decisions of some other discretionary entities. The bill will eliminate this increase in the state's contribution rate.

State Educational Institutions & Separate Bodies Corporate and Politic: The bill affects state educational institutions, as well as separate bodies corporate and politic, in as much as they may be miscellaneous participating entities and may choose to withdraw from PERF (either in whole or in part) or may restrict new employees from enrolling in PERF. In those cases where they do withdraw employees or restrict enrollment into PERF for new employees, they are liable for the future benefits payable for their current and former employees who are enrolled in PERF.

Directly impacted by the bill are four state educational institutions that are known to have “frozen” new employees from participation in PERF since December 31, 2010. These institutions include Ivy Tech, Indiana University, Purdue University, and the University of Southern Indiana. The net present value of the total liabilities owed by these institutions is $73 M.

These entities will collaborate with INPRS to determine the total amount of the outstanding liability.

Any miscellaneous participating entity who withdraws or freezes from PERF and chooses to continue to offer a retirement plan for employees must participate in either the ASA Only Plan or another defined contribution plan.

Office of Management and Budget (OMB): Currently, local units must report on their various retirement plans annually through the Gateway for Government Units. The State Board of Accounts must report on this submitted data annually to the Interim Study Committee on Pension Management Oversight. The bill requires that OMB shall compile a written report for the Committee that summarizes and analyzes the retirement plan information received each year. The bill’s requirements are within the agency’s routine administrative functions and should be able to be implemented with no additional appropriations, assuming near customary agency staffing and resource levels.

As of November 2014, 418 local units of government reported 418 retirement plans. These plans do not include plans administered by INPRS. These plans consist of defined benefit, defined contribution, and hybrid retirement plans. Approximately 39% of these plans are defined benefit plans.

ASA Plan for New Employees: The bill requires that new state employees will be automatically enrolled in the ASA Only Plan instead of PERF, unless the employee elects to do otherwise. Currently, the opposite is true, and new employees default to PERF membership. LSA estimates that roughly 3,000 new state employees will be eligible for enrollment in the ASA Only Plan each year.

The bill is expected to greatly increase the number of new state employees that become members of the ASA Only Plan. This will not immediately have an impact on state employer contribution rates (which are 11.2% in FY 2015). Employees will contribute 3% of their salary (which is picked up by the state for state employees), and state contributions are the same for the ASA Only Plan as for PERF. Specifically, the employee’s account receives a minimum of 3% and not greater than the actuarial normal cost of the Hybrid Plan, currently 4.6%. The amount not credited to the member’s account is applied to PERF’s unfunded liability (11.2% less 4.6%, which equals a 6.6% contribution to PERF’s unfunded liability).

However, it is likely that over the long term, the shift of new employees to the ASA Only Plan will decrease costs for the state, as the unfunded liability of PERF decreases. Also, in times of a bad economy, to the extent that more PERF assets are part of the ASA Only Plan, losses to the state will be minimized. In the case of PERF, the unfunded liability will increase in an economic downturn as the value of assets decrease, thereby increasing state costs.

INPRS: The bill requires that INPRS calculate additional amounts owed by miscellaneous participating entities or political subdivisions who choose to freeze enrollment in PERF. INPRS will calculate these amounts and will share their calculation method with the freezing entities. Additionally, the bill requires that INPRS calculate supplemental contribution rates for local employers who transition from PERF to the ASA Only Plan. INPRS is required to report annually to the Interim Committee on these supplemental contributions.

The bill eliminates the use of paper checks to INPRS' beneficiaries. The vast majority of pension plan members and beneficiaries receive their monthly benefits through direct deposit. Currently, a member or beneficiary must submit a waiver to INPRS in order to receive a paper check. INPRS spent $212,400 issuing 180,000 paper checks to members and beneficiaries in FY 2014. The bill will allow the INPRS board, at their discretion, to provide electronic benefit transfer (EBT) cards in lieu of paper checks, thereby eliminating this expense.

The bill will require that INPRS deal with a potential increase of new local employers in PERF and the ASA Only Plan. Also, INPRS will, over time, shift resources from PERF to the ASA Only Plan, as more and more active members age out of PERF.

The bill's requirements may represent an additional workload for INPRS outside of the agency's routine administrative functions. Therefore, existing staffing and resource levels, if currently being used to capacity, may be insufficient for full implementation.

Typically, administrative costs of INPRS are absorbed by investment earnings from the respective pension funds.

1977 Fund: The bill permits a member who wishes to retire from the 1977 Fund to be immediately rehired by the same unit for a position not covered by the 1977 Fund. Currently, there is a minimum period of separation from employment required before the unit may rehire the 1977 Fund retiree. This provision will have no fiscal impact on the 1977 Fund or INPRS.

Additional Information: Several local entities as well as state educational institutions have restricted membership in PERF to new employees since 2011. These decisions were allowed according to existing PERF statute, and these entities were able to do this, in some cases, without providing notice to INPRS.

This restriction or "freezing" is different from a withdrawal, where notice to INPRS is required. It is possible, due to the lack of a notice requirement for freezing, that there are additional entities that have done this and are planning to act in a similar manner to these entities that have already placed "freezes" on PERF enrollment.

PERF is a cost-sharing pension plan where all employers pay the same contribution rate (currently 11.2% for all but a handful of local employers). Consequently, when these entities froze enrollment into PERF, they shifted some of the liabilities for their current and former employees in PERF to the other PERF employers. This is due to the fact that the affected discretionary entities are paying a contribution rate based on a gradually shrinking affected payroll (since the contribution rate is only paid on the portion of the employer's payroll that is covered in PERF).

According to INPRS, the decisions by these entities will cost other PERF employers approximately $97 M in additional liabilities in today's dollars.

It is expected that these additional liabilities will be slowly absorbed by the remaining employers through 2043 and will, over time, increase their contribution rate by 0.23%. By 2043, the $97 M liability shift will ultimately cost the remaining employers $256 M.

Move to ASA Only Plan: PERF members typically participate in a hybrid pension system, consisting of both a conventional pension benefit and an annuity savings account (ASA) which is funded by member contributions. State employees who are members of PERF have their 3% member contribution into the ASA "picked up" by the state, which means that the state, as the employer, makes the contribution on the member's behalf. Members are then able to contribute an additional amount (either pretax or posttax) to the ASA. Currently, member contributions are limited to 10% of their salary per pay period.

The ASA Only Plan, which began operating in March 2013, is available to new state employees who were not previously members of PERF. Employer contributions are identical for both the ASA Only Plan and PERF.

In the ASA Only Plan, the employee's account receives a minimum of 3% and a variable rate contribution that is not greater than the actuarial normal cost of PERF, currently 4.6%. The amount not credited to the member's account is applied to the Hybrid Plan's unfunded liability (11.2% less 4.6%, which equals a 6.6% contribution to PERF's unfunded liability).

Some new employees may choose the ASA Only Plan due to the fact that members in the ASA Only Plan are 100% vested in the ASA Only Plan after 5 years, whereas PERF members are vested after 10 years. The vesting on the ASA Only Plan only refers to the variable rate contribution - the 3% employer contribution and any additional employee contributions are immediately 100% vested.

Explanation of State Revenues:

Explanation of Local Expenditures: *Withdrawal/Freezing from PERF*: Political subdivisions or school corporations that choose to restrict future enrollment in PERF will be required to pay an amount determined by INPRS in order to cover the entire amount of liabilities of their current and former employees who remain in PERF.

Directly impacted by the bill are Marion County Health and Hospital and the Tri-Creek School Corporation, both of which have "frozen" new employees from participation in PERF since December 31, 2010. The known PERF liabilities for these two entities have a net present value of approximately $24 M.

Any political subdivision who withdraws or freezes from PERF and chooses to continue to offer a retirement plan for employees must participate in either the ASA Only Plan or another defined contribution plan.

Mandatory Participation in PERF or ASA Only Plan: Approximately 1,200 local units participate as employers in PERF currently. The bill requires that local units who previously did not offer retirement plans to their employees but choose to do so after July 1, 2015, must participate in either PERF or the ASA Only Plan. There are roughly over 3,800 units that may possibly be affected by the bill. If all of these units opt to provide retirement benefits (and therefore become part of PERF or the ASA Only Plan), the number of local employers in PERF or the ASA Only Plan could greatly increase.

Local units that have pre-existing pension plans (outside of PERF and the ASA Only Plan) and wish to continue providing pension benefits will be able to continue to use pre-existing pension plans for both current and future employees.

(Revised) *Participation in ASA Only Plan:* Local employers may choose to opt into the ASA Only Plan for their new employees. Currently, the ASA Only Plan is only available to new state employees. If a local employer opts to participate in the ASA Only Plan, the local unit will decide if new employees may enter PERF or the ASA Only Plan or, if the employer is leaving plan participation up to the new employees, whether the default is PERF or the ASA Only Plan. If a local employer makes no change, then future employees will automatically be enrolled in PERF.

(Revised) *New Local Employer ASA Only Plan Contribution Rate Calculation:* The bill changes the contribution rate for local units that opt to enroll employees into the ASA Only Plan.

Currently, in the ASA Only Plan (for state employees), employers contribute the same amount for the ASA Only Plan as they do for PERF (11.2% of the employee's compensation). The employee's account receives a variable rate contribution that is not less than 3% and not greater than the actuarial normal cost of PERF, currently 4.6%. The amount not credited to the member's account is applied to the Hybrid Plan's unfunded liability (11.2% less 4.6%, which equals a 6.6% contribution to PERF's unfunded liability). Additionally, the employee is responsible for a 3% contribution, which may be "picked up" by the employer. The state automatically "picks up" this contribution for the employee and approximately 50% of local units "pick up" this contribution for their employees.

The bill changes this contribution rate by doing the following:

(1) The bill excludes the percentage that goes towards the unfunded liability for PERF (currently 5.4%).
(2) The bill changes the variable rate contribution so that it is between 0% and the normal cost of PERF (currently 5.8%).
(3) The bill then allows local units to match employee contributions in excess of the required 3% (up to 10%). The matching rate may be either 0% or 50%. Employees may contribute up to 10% of their compensation into the Plan. However, 3% of this contribution is mandatory so the matching is applied to anything over that 3% and up to 10%. The maximum match would be 50% of 7%, or 3.5%.

The final contribution rates paid for ASA Only Plan members due to the bill will depend upon the decisions of local units. However, it is conceivable that they may be as low as 0% and as high as 9.3%. Once the supplemental contribution is added (see *Employer Supplemental Contributions* section below), the rate may be as high as 14.7%.

Local employers still have discretion as to whether they would like to "pick up" the mandatory 3% employee contribution. The calculation above does not include any "pickup".

(Revised) *Employer Supplemental Contributions:* The bill provides that INPRS may charge an employer a supplemental contribution, if necessary, to fund the employer's share of the actuarial unfunded liability due to the fact that all or a portion of the employer's employees are a member of the ASA Only Plan (as opposed to PERF).

This provision is expected to impact local units who opt to enroll any or all new employees into the ASA Only Plan instead of PERF. This is due to the change in the contribution rate for ASA Only Plan members who are employees of local units. Since employers are no longer paying for a portion of the PERF unfunded liability in the contribution rates for ASA Only Plan members, without a supplemental contribution by the employer, PERF would realize a loss with each new employer who enrolled employees into the ASA Only Plan.

Therefore, these employers who opt into the ASA Only Plan will be required to pay an amount determined by INPRS in order to cover the entire amount of liabilities of their current and former employees who remain in PERF.

Currently, INPRS calculates that any local employer who opts to enroll new employees into the ASA Only Plan will pay an additional 5.4% in supplemental contributions for those employees.

1977 Fund: The bill permits a member who wishes to retire from the 1977 Fund to be immediately rehired by the same unit for a position not covered by the 1977 Fund. Currently, there is a minimum period of separation from employment required before the unit may rehire the 1977 Fund retiree. This provision will have no fiscal impact on 1977 Fund employers.

Explanation of Local Revenues:

State Agencies Affected: INPRS; OMB; State educational institutions; State separate bodies corporate and politic; All.

Local Agencies Affected: All.

Information Sources: 2014 INPRS Update to the Indiana State Budget Committee, November 20, 2014; INPRS presentation to the Pension Management Oversight Committee, September 16, 2014 (https://iga.in.gov/documents/585f90b9); Kathryn Hoffman, INPRS, khoffman1@inprs.in.gov; Tony Green, INPRS, agreen@inprs.in.gov; Indiana Gateway for Government Units local pension data, https://gateway.ifionline.org/ (Accessed 11/25/14).

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